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Policies for Stagflation: Focus on Supply, two volume record of conference held in Toronto November 24 and 25, 1980, The Ontario Economic Council, Special Research Report, Volume 1-118 pages, Volume 2-94 pages, price: \$10.00*

TORONTO, July 29, 1981 -- Remedies for the problem of stagflation (rising prices accompanied by unemployment and falling output) require a vigorous and comprehensive strategy of money supply manipulation and expansionary fiscal policies, say some of the papers included in the special conference report released today by the Ontario Economic Council. But the authors and commentators are not unanimous in this.

Conference participants evaluate various components of stagflation and criticize some current anti-inflation

*This report reflects the views of the authors and not necessarily those of the Ontario Economic Council or the Government of Ontario. The Council establishes policy questions to be investigated and commissions research projects, but it does not influence the conclusions or recommendations of the authors. The decision to sponsor publication of this study was based on its competence and relevance to public policy.

devices built into pricing decisions, the tax and transfer system, and wage settlement formulas, which perpetuate rather than relieve the problem. Indexing, for example, involved not only accepting the inevitability of rapid inflation but also may have reinforced it, argues T. K. Shoyama, Visiting Professor at University of Victoria's School of Public Administration and Centre for Pacific and Oriental Studies.

"Supply-side inflations are stagflations with rising prices that are accompanied by unemployment and falling output. The 'stag' part of the inflation can only be avoided by increasing the money supply sufficiently to alleviate the money shortage and prevent interest rates from rising. In this case prices rise but output and employment do not fall", says Richard Lipsey, Professor of Economics at Queen's University. Sustaining the growth rate is vital, he warns to attacking the supply-side of stagflation.

"We must rely on the private sector to provide entrepreneurship and innovation. But we also need to identify and avoid the government policies that inhibit the growth of supply and to identify and adopt the policies that, in the realities of the late twentieth century political economy, encourage the growth of supply."

A different viewpoint is discussed by Barry Bosworth, Senior Fellow, The Brookings Institution. "A solution to inflation requires a long-term commitment by government to refuse to accommodate inflation through increases in the supply of money. The unemployment costs of such a policy will remain high only until the participants in the market realize that the government means it. The problem is seen as one of making the government's policy credible, thus reducing expectations of inflation."

Collective bargaining, Bosworth says, operates similarly to a bilateral monopoly and has helped weaken the immediate effects of supply and demand. He observes that "wage agreements in the large unionized firms show little or no sensitivity to cyclical changes in the labour market. These tendencies are reinforced by the practice of multi-year bargaining, under which the current year's wage increase reflects economic conditions of previous years or is indexed to current rates of price inflation. Despite the disaster that has befallen the automobile industry, for example, the pattern of wage increases in that industry will continue to be dominated by a basic formula agreed to in 1948 (a cost-of-living adjustment plus a fixed annual improvement factor). The dilemma facing political leaders, he concludes, is that economists "prescribe no means of breaking the momentum of inflation without extremely high costs in terms of unemployment."

Effects of the changes made during the 1970s in Canada's tax and transfer system on labour supply, capital formation and price levels are analyzed in the report. Except for unemployment insurance, those tax changes "would have had a positive impact on aggregate supply had they not been offset by inflation-induced tax increases." The system's redistributive structure accounted for some of the reduction in the labour supply, according to the paper by Douglas G. Hartle, Samuel Rea, Gregory V. Jump and John Bossons, all at The Institute for Policy Analysis, University of Toronto. Three tax changes it recommends to stimulate productivity are indexing the 1) capital cost allowances 2) cost base of publicly traded corporate equity securities for capital gains tax purposes and 3) interest income and carrying charges.

Reductions in American productivity are examined "through a three-layer grid" by Lester C. Thurow, Professor of Economics at Massachusetts Institute of Technology. He analyzes the sources of productivity decline 1) in and across various industries 2) in relation to reductions in capital and labour and 3) as a consequence of "adverse shocks - energy prices and availabilities, rules and regulations." Problems in agriculture, construction, mining, utilities and services, he says, account for about 57 percent of the productivity decline from 1972 to 1978, and "most of the remaining 43 percent of the decline can be traced to the interaction of two other factors - the macro-economic policies used to fight inflation and the baby boom."

Thurow criticizes American tight monetary policies and argues that "deflation also means recessions, falling production, and idle capacity. Why should firms invest in more capital capacity when they already have vast amounts of idle capital capacity? They should not. And very few do. The result is less capital per worker in the next economic boom."

The formation of a "national finance committee" is recommended by Thurow as a means of directing capital into new growth industries through an efficient industrial policy that aids winners, not losers. "Everyone wants a cure to the productivity problem, but everyone wants the cure to be imposed on someone else. If we cannot find the political will to impose the costs upon ourselves in some fair manner, we simply will not solve the problems facing us."

This conference report was prepared under the auspices of the Ontario Economic Council, established in 1962 as an independent public policy institute. The Council undertakes research and policy studies to encourage the optimum development of the human and material resources of the province and to support the advancement of all sectors of Ontario. The Council achieves these goals by sponsorship of research projects, publication of studies and organization of conferences and seminars which are open to the public.

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NOTE: A list of persons to contact and a biographical sketch of the authors are attached.

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